STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**6/26/03**	Bill No:	**SB 17**
Tax:	**Property**	Author:	**Escutia**
Board Position:		Related Bills:	**SB 3x (Escutia)** **ACA 16 (Hancock)**

BILL SUMMARY

This bill would:

- Require the Franchise Tax Board to furnish the Board of Equalization (Board) with the name and address of any entity that does not respond to a question concerning change in ownership on partnership, bank, and corporate tax returns. *§64*
- Require publicly traded companies to file annual real property statements with the Board and impose a penalty for failure to file the statement timely. *§471*
- Specify that the Board may subpoena witnesses or the production of information or records regarding changes in ownership or real property statements filed by publicly traded companies. *§486*
- Establish a penalty if a legal entity does not file a change in ownership statement with the Board within 60 days after a change in control or change in ownership under Section 64 (c) or (d) occurs. *§480.1, §480.2, and §482.*
- Modify and, potentially, increase penalties if a legal entity does not respond timely to a written request by the Board to file a change in ownership statement . *§482*
- Make various legislative findings and declarations related to change in ownership of nonresidential commercial and industrial property.

Summary of Amendments

Since the previous analysis, the provisions related to the Real Property Statement filed by publicly traded companies were amended to:

1. Clarify that annual real property statements filed by publicly traded companies are to include new acquisitions of property.
2. Limit the reporting of leased real property to those leases that had an original term of 35 years or that have a remaining term of 35 years or more, including renewable options.
3. Clarify that in the event a statement is filed, but some parcels of real property are not reported, the 10% penalty applies only to those parcels not reported.

- Provide that the penalty for failure to file a change in ownership statement within 60 days of the triggering event is to be applied to each property subject to reassessment and reduce the penalty to the greater of $1,000 or 10% of the taxes resulting from the new base year value.

- Restore the ability for the Board to request that legal entities file change in ownership statements and the related penalty structure.

ANALYSIS

Current Law

A. Change In Ownership Definitions

Under existing property tax law, real property is reassessed to its current fair market value whenever there is a "change in ownership." (*Article XIIIA, Sec. 2; Revenue and Taxation Code Sections 60 - 69.5)*

Revenue and Taxation Code Section 60 defines a "change in ownership" to mean a transfer of present interest in real property including the beneficial use thereof, and the value of which is substantially equal to the value of the fee interest.

Revenue and Taxation Code Section 64 sets forth the change in ownership provisions related to the purchase or transfer of **ownership interests <u>in</u> legal entities** that own real property. Generally, when real property is owned by a legal entity, the purchase or transfer of ownership interests in that legal entity does not trigger a change in ownership of the property.

An exception to this general rule is when there is a **"change in control"** of the legal entity or upon the transfer of more than 50% of "original coowners" interests. Subdivision (c) of Section 64 generally provides that a "change in control" occurs when **one person** or legal entity **acquires more than 50 percent** of the ownership interests in the legal entity. Subdivision (d) of Section 64 provides that if real property was excluded from a change in ownership when transferred into a legal entity under Section 62(a)(2) and the holders of the ownership interests became "original coowners" the subsequent transfer of more than 50% of those original co-owner's shares are transferred results in a change in ownership of the real property that was previously excluded.

B. Change in Ownership Reporting

Under existing law, Sections 480.1 and 480.2 require legal entities to file a change in ownership statement within 45 days of a change in control or change in ownership under Section 64(c) or 64(d). However, there is no penalty for not filing the statement within the 45 day period. A penalty applies only if the Board makes a written request to the legal entity to file a statement and the legal entity fails to respond. Section 482 outlines the penalties to be charged if the statement is not filed within 45 days of a written request by the Board. The penalty is:

- 10 percent of the taxes applicable to the new base year value reflecting the change in control or change in ownership of the real property owned by the legal entity, *or*
- if no change in control or change in ownership occurred, 10 percent of the current year's taxes on that property shall be added to the assessment made on the roll.

The penalties for failure to respond to a Board written request apply whether or not it is determined that a change in ownership actually occurred. However, the penalty is automatically extinguished if the person or legal entity files a complete statement no later than 60 days after the date on which the person or legal entity is notified of the penalty.

To help discover changes in control of legal entities, information is requested on the state income tax return as required by subdivision (e) of Section 64. The Franchise Tax Board provides the information provided by taxpayers on the tax return form to the Board.

Under existing law, Section 484 provides the assessor with a variety of mechanisms to secure change in ownership information including the authority to seek a court order to require persons refusing to provide information or records to provide the information pursuant to Section 468. Government Code Section 15613 provides that the Board may issue subpoenas for the attendance of witnesses or the production of books, records, accounts, and papers.

Proposed Law

A. Change In Ownership Definitions

The legislative findings and declaration would state that because of difficulties in identifying changes in ownership of certain nonresidential commercial and industrial properties, these properties often escape reassessment at full market value upon a change in ownership.

B. Change in Ownership Reporting

Publicly Traded Companies. This bill would add Section 471 to the Revenue and Taxation Code to require publicly traded companies (except for state assessees) to file annual real property statements with the Board by March 1 of each year. The statement would list all of the real property owned or leased in California, by county, as of December 31 of the prior calendar year. Leased property would be limited to leases that had an original term or that have a remaining term of 35 years or longer, including renewable options. Each property listed is to be identified by assessor parcel number. If a company does not file a statement that contains all of the required information by April 15, then a 10% penalty based on the current year’s taxes on all of the real property owned by the company in the state would be levied. After the first statement is filed, subsequent statements would be limited to property that has been transferred or acquired during the immediately preceding calendar year. The Board would transmit any relevant information contained in the statement to the assessors of the counties in which the property is located.

All Legal Entities. This bill would amend Section 480.1, 480.2 and 482 to modify the requirements and penalties for legal entities to file a change in ownership statement with the Board after a change in control or change in ownership under Section 64(c) and (d). Specifically, it would:

1. **Requirement to Report.** This bill would extend from 45 to 60 the number of days to file a change in ownership statement with the Board after a change in control or change in ownership under Section 64(c) or (d).
2. **Failure to Report.** This bill would also establish a penalty if the legal entity does not report the change in control or change in ownership within the required time period. The penalty would be levied on each property subject to reassessment at the greater of (1) $1,000 or (2) 10 percent of the taxes applicable to the new base year value reflecting the change of control.
3. **Board Discovery and Investigation into Potential Changes in Ownership.** This bill does not change the requirement to file a change in ownership statement after a written request by the Board. Nor does it change the penalty structure, or automatic abatement provisions, for not timely filing a statement after a written request. This bill would specify that any penalty levied for failure to respond timely to a Board inquiry is in addition to any penalty that may be levied for failure to report the change in ownership by filing a change in ownership statement.
4. **Misrepresentations.** If a legal entity misrepresents that a change in control or change in ownership did not occur**,** when one did, the penalty on each property would be the greater of (1) $2,500 or (2) 25% of the taxes applicable to the new base year value. If a legal entity misrepresents that a change in control or change in ownership occurred, when one did not (i.e., to lock in a lower base year value in a depressed real estate market), the penalty on each property would be the greater of (1) $2,500 or (2) 25% of the current year's taxes on each property.

All Legal Entities. This bill would amend Section 64 to require the Franchise Tax Board to furnish the Board with the name and address of any entity that does not respond to the change in ownership question on partnership, bank, and corporate tax returns.

Failure to Provide Information. This bill would add Section 486 to provides that the Board may issue subpoenas pursuant to Government Code Section 15613 for the attendance of witnesses or the production of information or records to secure change in ownership required for assessment purposes or securing real property ownership information pursuant to newly added Section 471.

In General

The Board of Equalization's Legal Entity Ownership Program (LEOP) was formed to assist in the discovery of changes in control and ownership of legal entities pursuant to subdivisions (c) and (d) of Section 64 of the Revenue and Taxation Code.

- Under Section 64(c) whenever a person or legal entity acquires more than 50% of the ownership interest in another legal entity, the real property of the acquired entity is reassessed.

- Section 64(d) provides that if real property was excluded from a change in ownership under Section 62(a)(2) when transferred into a legal entity and subsequently more than 50% of those original co-owner's shares are transferred, the real property that was previously excluded will be reassessed.

The LEOP unit assists assessors in discovering changes in ownership or control that might not otherwise be captured by a county's own discovery systems. Discovery of these changes is required by law and can be difficult because ordinarily there is no recorded deed or notice of a transfer of an ownership interest in a legal entity.

LEOP Operations

- Receives a list from the Franchise Tax Board of legal entities that have reported a change in ownership on their income tax returns or have left the question blank.
- Monitors business publications, such as *Mergers & Acquisitions* and the Wall Street Journal.
- Sends a "Statement of Change in Control or Ownership of Legal Entities" to each entity.
- Analyzes completed statements to determine whether there has been a change in control or ownership.
- Notifies county assessors of changes in control and ownership.

Background

The Legal Entity Ownership Program (LEOP) started in January 1983 as a result of Chapter 1141 of the Statutes of 1981 (AB 152). The resulting Sections 480.1 and 480.2 of the Revenue and Taxation Code require the Board to participate in the discovery of changes in control of corporations, partnerships, and other legal entities. It was recognized that such events, which are not evidenced by a recorded document, would fall outside the parameters of assessors' normal means for discovering changes in ownership.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the Pacific Institute for Community Organization (PICO) www.PICOcalifornia.org and the California Tax Reform Association www.caltaxreform.org. Its purpose is to ensure that legal entities properly report changes in ownership.
2. **Key Amendments.** The **June 26** amendment, relating to the requirement that publicly traded companies annually report their real property holdings, provides that acquisitions of property during the year are to be listed, limits the reporting of leased property, and provides that if the statement is filed but some parcels of real property are not listed, the 10% penalty only applies to the properties that were not listed. The amendment also restores the Board's ability to request that legal entities file change in ownership statements upon written request and levy penalties for failure to respond, and adds a provision that the Board may subpoena information and records to secure change in ownership information. The **May 22** amendment, relating to the requirement that publicly traded companies annually report their real

property holdings, specifies the date, December 31, as of which all real property holdings for the year would be reported for the following year. The amendment also provides that the penalty for failure to provide a complete statement would not be imposed as a result of a reasonable error or omission on the statement that is filed. The **May 14** amendment provided that any penalties levied on a legal entity for failure to a file change in ownership statement would be added to the assessment roll, as current law provides. (The April 21 amendment would have transferred any penalty monies from local governments to the Board.) The **May 6** amendment provided that when the Board receives real property statements from publicly traded companies, it would transmit any relevant information contained in the statement to the assessors of the counties in which the affected property is located. The **April 21** amendments added the requirement that publicly traded companies annually file real property statements with the Board and modified the requirements and penalties for legal entities to file a change in ownership statement with the Board after a legal entity change in control. See the prior analysis of the 12/02/02 version of the bill for a full discussion of change in ownership of property owned by legal entities.

3. **Changes in ownership or control of a legal entity triggered due to transfers of ownership interests in legal entities (Section 64(c) and (d)) are not easy to discover.** Unlike transfers of interests in real property, a deed is not recorded with the county recorder nor is there any other type of public notice that the assessor could use to track transfers of ownership interest in a legal entity.

4. **The law requires legal entities to file a change in ownership statement within 45 days of the event, but there is no penalty if they fail to do so.** Under current law, a penalty is incurred only if a legal entity does not respond to a written request by the Board to file a statement and the entities are given two opportunities to provide information before a penalty is levied. This bill would establish a consequence upon those entities that do not initiate filing a change in ownership statement within the required time period. It would additionally extend the number of days for legal entities to report the change in ownership from 45 to 60 days.

5. **This bill would require that publicly traded companies (except state assessees) provide the Board with a list of real property they own in California.** When the Board discovers a change in ownership of a legal entity from a source other than filing a change in ownership statement without any prompting by the Board, this information could be used to provide a county assessor with information about properties subject to reappraisal located in his or her county. Currently, the Board does not maintain an inventory of any legal entity's real property holdings in California. State assessees would not be required to file these statements as they are already required to report their real property holdings in other documents filed with the Board.

6. **In contrast to the income tax returns for income tax purposes, the requirement to file a change in ownership statement for property tax purposes is not widely known or understood.** Legal entities may not file statements, in part because the legal entity may not understand that for California

property tax purposes, transfers of ownership interests in the legal entity have triggered a change in ownership. It is especially difficult for property tax administrators to discover changes in ownership of property that occur under Section 64 (d). These properties have been previously excluded from change in ownership under Section 62(a)(2). They fall into a special class that requires that cumulative transfers of interests in the legal entity be tracked to determine when more than 50% of the total interests in the legal entity have been transferred. At that point, the legal entity must report the change in ownership and the property previously excluded from change in ownership is subject to reassessment.

7. **The Franchise Tax Board currently informs the Board of legal entities that leave the property tax questions blank on their income tax returns**. This provision would codify existing adminstrative practices.

8. **As an aid in discovering changes in ownership of property owned by legal entities, the Board routinely sends statements to legal entities based on information from the property tax question on the state income tax return and from monitoring various business publications, such as Mergers & Acquisitions and the Wall Street Journal.** This bill would not modify the requirement to file a statement upon Board request and the penalty for failure to respond to the Board request for information. These penalties can apply whether or not a change in ownership actually occurred. This bill would add a new penalty, in the event a legal entity misrepresents the occurrence or nonoccurrence of a change in ownership on the statement filed at the level of the greater of (1) $2,500 per property or (2) 25% of the taxes applicable to the new base year value, or 25% of the current year's taxes on each property if no change in ownership occurred.

9. **The penalty provisions in this bill would be determined and applied to each property.** Determining whether the flat penalty or the percentage penalty applies is calculated at the level of each property owned by the legal entity subject to a penalty provision. Generally, the flat amount of $1,000 would apply on any real property with a value of less than $1 million in current fair market value (or less than $1 million in factored base year value where no change in ownership occurred). One thousand dollars is greater than 10% of the taxes on a property with a new base year value of $1,000,000 or less.

   $1,000,000 x 1% tax rate = $10,000 tax
   $10,000 x 10% = $1,000 penalty

   For instance, a legal entity could own one property or 100 properties in California. If a legal entity had four properties each with a fair market value of less than $1,000,000, the total penalties would be $4,000. If it had 50 properties statewide, each less than $1,000,000 in value, the total penalty would be $50,000. For each property, the penalty would be the greater of $1,000 or 10% of the tax, so for any property over $1,000,000 the penalty would switch to the 10% calculation. For example, a $5,000,000 property would result in a $5,000 penalty.

   $5,000,000 x 1% tax rate = $50,000 tax
   $50,000 x 10% = $5,000 penalty

10. **This bill establishes a penalty for misrepresenting that a change in ownership has occurred**. In periods of declining real estate value, some property owners have inquired about methods to intentionally trigger a "change in ownership" to lock in a new lower base year value.

11. **Related legislation.** Senate Bill 3x contains intent language identical to the intent language in this bill. Assembly Constitutional Amendment 16 (Hancock) would place a constitutional amendment before voters to require annual reassessment of nonresidential, nonagricultural property to current fair market value.

COST ESTIMATE

Pending. The Board would incur additional costs for processing, filing, and maintaining the new real property statements filed by publicly traded legal entities.

REVENUE ESTIMATE

This measure has no direct revenue impact. Increased penalties may be an incentive for legal entities to properly file a change in ownership statement when a change in ownership occurs.

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